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CAPITAL FORMATION WITHIN THE ELECTRIC UTILITY INDUSTRY: AN ASSESSMENT OF THE FORD PLAN*

INTRODUCTION

The 1973 oil embargo dramatized the need for less dependence on foreign energy sources. One way to reduce dependence on foreign oil is to construct more electric power plants which are not fueled by petroleum, but by energy sources plentiful in the United States, i.e., coal, nuclear, or solar energy. Nevertheless, the utility industry recently has reduced construction, claiming inability to

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* The author would like to thank Ms. Penny Parker for having originally shown him the centrality of capital formation with respect to energy policy decision-making.


2. Throughout this Comment, the words “utility” and “industry” will be used interchangeably to mean investor-owned electric utility companies.

In 1973, investor-owned electric utility companies served 78.3 percent of the total ultimate consumers of electric power. Sales to these consumers represented 78.3 percent of all kilowatt hours sold. Industry revenue equaled 26.3 billion dollars. Financial Problems of the Electric Utilities: Hearings on S. ___ Before the Senate Committee on Interior and Insular Affairs, 93 Cong., ___ Sess., ser. ___, pt. ___, at 441 (statement of Professor M.L. Weidenbaum, Director of the Center for the Study of American Business at Washington University, St. Louis, Missouri, and a former Assistant Secretary of the Treasury for Economic Policy, 1974) reprinted under sep-
raise sufficient capital to invest\(^3\) in new power plants.\(^4\)

In response to this problem, the Ford Administration has proposed a system of tax incentives to encourage the construction of more nonpetrol based power plants.\(^5\) The Ford plan provides for: 1) An indefinite extension of the investment tax credit at 12 percent; 2) an immediate investment tax credit on progress payments; 3) extension of rapid amortization of pollution control facilities to January 1, 1981; 4) rapid amortization of conversion costs from petroleum to nonpetroleum plants; 5) a depreciation allowance for funds used during construction (AFDC), and 6) postponed taxation of qualified dividends reinvested in a utility.\(^6\)


\(^{5}\)At the end of 1974, it is estimated that electric utilities had deferred or cancelled the construction of 106 nuclear plants (114,000 megawatts) and 139 coal-fired plants (74,413 megawatts). *FEA, Draft Environmental Impact Statement of the Electric Power Facility Construction Incentives Act of 1975* at 2 (DES 75-4, 1975) on file with the Federal Energy Administration, 40 Fed. Reg. 34025 (1975) [hereinafter cited as *DES 75-4*].


It is doubtful that this specific proposal will be enacted as proposed by the Administration. Wall Street J., June 16, 1975, at 4, col. 3. Nevertheless, the idea of federal assistance for the financing of energy supply expansion continues to be prominent among top Administration officials. For example, Vice-President Rockefeller has proposed the creation of an Energy Resources Finance Corporation (Erfco).

[T]he corporation's purpose would be mainly to aid in development of such synthetic fuels as oil shale and in making oil and gas from coal. This would be done through direct loans, loan guarantees or agreements by the company to buy such fuel and resell it. Wall Street J., Sept. 10, 1975, at 3, col. 3 (pac. ed.). (The Wall Street Journal is bound in the eastern edition).

In addition, Erfco would incorporate the present proposals to assist utility financing. *Id.*

The House Ways and Means Committee has not acted on the Ford proposal as a whole. On October 28, 1975 the Committee staff was prepared to present the Ford plan to the full Committee. In an unusual move, the Republican members of the Committee did not move the initiative. According to a Committee spokesperson, the plan may be introduced in the Senate, where chances for more favorable committee action exist, or in a Special
The purpose of this Comment is to analyze the justifications offered for federal legislation, to critique the Ford plan and to offer an alternative policy option.

THE JUSTIFICATION FOR FEDERAL LEGISLATION

Before 1980, utilities must raise approximately $140 billion to finance expansion. Declining profits make it difficult to attract equity investors. In particular, the utilities have been unable to obtain greater debt capital because they are approaching the legal limits for the issuance of additional debt and competing sectors


8. See WEIDENBAUM 442-50.
9. Utility long-term debt indentures require that the company maintain a specified minimum ratio of earnings to interest charges, the coverage ratio. Increased debt financing becomes more difficult when this ratio declines because prior indentures limit the issuance of additional debt and bond ratings decline concomitantly with a consequent rise in interest costs. Present coverage ratios are approaching minimum requirements and profitability continues to decline. WEIDENBAUM 453-59. Those Public Utility Holding Companies subject to regulation by the Securities and Exchange Commission (SEC) must also meet the SEC's coverage ratios. Id. at 511. Finally, the utilities would ultimately be limited in their ability to raise external capital by state laws which require minimum coverage ratios (or the like) before certain investors can invest in a corporation. Id. at 512. See, e.g., CAL. FIN. CODE § 1386(a) (West Supp. 1975), amending §§ 1386, 1386(b)
of the economy have become more attractive to investors.10

Utility rates are primarily determined by state regulatory commissions.11 Judicial decisions on utility financing have had a limited impact on capitalization. The Supreme Court has set standards as to the fair rate of return on investment which state regulatory commissions must grant any public utility, but the commissions are still responsible for the substantive decisions which determine utility rates.12 Faced with consumer opposition, these commissions have been reluctant to approve higher rates.13


10. WEIDENBAUM 474-77.


13. Hamer, supra note 11, at 194-96; Hickman, Tax Equity and the Need for Capital, 23 NAT'L TAX J. 282, 285 (1975). The Administration had "jawboned" state regulatory commissions for higher utility rates. Hamer, supra note 11, at 189. See, e.g., Wall Street J., Oct. 29, 1974, at 4, col. 2, id., July 9, 1974, at 14, col. 1 (statements by former Federal Energy Administrator John Sawhill). Recently, an Administration task force to reduce "impediments to the completion of electric utility plants . . ." addressed problems which may include unreasonable environmental restrictions and delays in processing papers, financing, regulatory delay, collective bargaining disputes, production delays in components, design issues, etc. This task force can expedite the completion of electric utility plants and getting power on stream. Tax Reform Hearings: Hearings on Tax Reform and Capital Formation and Tax Proposals Concerning Electric Utilities Before the House Committee on Ways and Means, 94th Cong., 1st Sess., at 59 (statement of the President's Labor-Management Committee, 1975).

While the operational effect of the task force is too recent to evaluate, excess federal intervention in state decision-making will probably result. Utilities have traditionally held the inside track at state regulatory commission hearings because of the hearings' obscurity and complexity. See WEIDENBAUM 483. An emergent consumer and environmental movement is only now providing a counterweight to utility persuasiveness. See Hamer, supra note 11, at 196. Given the goal of "getting power on stream," the "task force" will downplay consumer and environmental concerns.

Furthermore, who will decide what constitutes an "unreasonable environmental restriction" is not clear, much less what is an "unreasonable environmental restriction."

Asked . . . if the troubleshooters might intervene on the side of
Nor can firms increase the funds generated internally through depreciation. In *Commissioner v. Idaho Power*,¹⁴ the Supreme Court required a power company to depreciate trucks used to construct a transmission line over the longer useful life of the transmission line rather than the ten-year composite life of the trucks.¹⁶ The Court held that section 263(a)¹⁶ of the Internal Revenue Code required capitalization of depreciation on equipment used to build self-constructed capital assets (the transmission line's useful life) despite the depreciation deduction provisions of section 167(a).¹⁷

*Idaho Power* deprives the utility industry as a whole of $40 million dollars otherwise available for investment¹⁸ and shows why a judicial response to utility financing is inadequate. The Court was primarily concerned "with the necessity to treat construction-related depreciation in a manner that comports with accounting and taxation realities."¹⁹ Defining its role as one of interpreting the

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¹ a utility and against environmentalists in some disputes, Federal Energy Administrator Frank Zarb smiled and said he hoped it wouldn't come to that. He said the troubleshooters might try to engineer a compromise in such a case. Wall Street J., June 18, 1975, at 4, col. 4.

² Finally, these "task forces" are an improper allocation of decision-making power. Problems of where and when to place a power plant are unique to the state in which the plant is built. See *Resources for the Future Staff Report, U.S. Energy Policies 80* (1968). But see *Energy Policy Project of the Ford Foundation, A Time to Choose: America's Energy Future 260-68* (1974) (advocating regional control with public representation) [hereinafter cited as *EPP*].

³ In sum, state regulatory commissions have not responded to the alleged shortage of utility capital. But see Maryland Public Broadcasting System, "Wall Street Week #506," Sept. 5, 1975, at 17: "[U]tility commissions ... are being more lenient in allowing ... rate increases ..." Statement of Paula Hughes, Vice-President of Thomson & McKinnon Auchincloss Kohlmeyer. (Transcripts may be obtained from Wall Street Week, P.O. Box 85, Owings Mills, Md., 21117.) Federal pressure on the state commissions borders on an improper infringement of state decision-making power and has limited effect.


⁵ *Id.* at 5-6.


⁷ *Id.*, § 167(a).


⁹ 418 U.S. at 10.
Internal Revenue Code made it inappropriate for the Court to write a utility financing exemption into the Code.

Given the inadequacies of a regulatory, executive, or judicial response to the utility financing problem, the Administration has advocated tax incentives to encourage construction of nonpetroleum power plants. 20

THE FORD PLAN

Investment Tax Credit and Depreciation

With respect to the Investment Tax Credit (ITC) and depreciation, the Ford plan would: 21

(1) Increase the ITC permanently to 12 percent on all electric utility property except generating facilities fueled by petroleum products. . . 22

(2) Give electric utilities full, immediate ITC on progress payments for construction of property that takes two years or more to build, except generating facilities fueled by petroleum products, without regard to the five-year phase-in required by the Tax Reduction Act of 1975. 23

(3) Extend to January 1, 1981, the period during which pollution control facilities installed in a pre-1969 plant or facility may qualify for rapid five-year straight-line amortization. . . 24

(4) Permit rapid five-year amortization of the costs of either converting a generating facility fueled by petroleum products into a facility not fueled by petroleum products or replacing a petroleum-fueled facility with one not fueled by petroleum. . . 25

(5) Permit a utility to elect to begin depreciation, during the construction period. . . 26

Other than (3), the pollution clause, the plan would apply only if the state regulatory commission allowed the utility to include


22. The present codification of the ITC is INT. REV. CODE OF 1954, § 46(a)(1).

23. The five-year phase-in requirements, id. § 46(d)(7), were provided by the Tax Reduction Act of 1975.


25. A similar provision is not presently in the Internal Revenue Code. Similar bills have been previously introduced. See H. 8351, 94th Cong., 1st Sess. (1975).

26. Basically, these would be the same expenditures as those which qualify for an ITC on construction payments under the Tax Reduction Act of 1975, codified at INT. REV. CODE OF 1954, §§ 46(d)(2)-(4).
the applicable expenditure within the utility's rate base\textsuperscript{27} and to keep the monies saved by the tax cut in order to normalize the tax advantage for ratemaking purposes.\textsuperscript{28} When certain regulated utilities were shifting from straight-line depreciation to accelerated depreciation methods

some regulatory agencies required them to reduce their rates ("flow through") from the resulting tax saving \ldots. An alternative to flow-through is the normalization method of accounting. Under this method, the tax savings from accelerated depreciation are set up in a reserve to offset future tax expense when accelerated depreciation runs out.\textsuperscript{29}

Obviously, the deferred taxation funds will be invested until the tax is paid. It is anticipated that the funds will be used to construct additional power plants.\textsuperscript{30} Normalization is essential to the Ford plan for if "the entire tax benefit would flow through immediately in the form of reduced utility rates for consumers \ldots no real economic benefit would result for the utility\textsuperscript{31} and hence no additional construction would occur in the industry.

The Ford plan would allow the utilities $3.7 billion in interest and tax savings during the 1975-80 period.\textsuperscript{32} For fiscal year 1976, the program would cost the Treasury between $600 million\textsuperscript{33} and

\begin{itemize}
  \item In simplest terms, regulators perform two tasks. The first is to determine the company's "overall revenue requirements." These must be sufficient to cover all costs (which include operating expenses, depreciation, interest, and taxes) and to yield a fair profit, or "rate of return," which enables the company to attract the necessary capital for maintenance and expansion of its services. The second task is to devise the appropriate rate structure, consisting of a schedule of charges which, when applied to the various services that the company provides, will satisfy the overall revenue requirements. For both of these steps it is necessary to determine the value of the "rate base"—the company's capital investment in plant and equipment used in providing each regulated service—because the amount of profit that the company is allowed to earn is expressed as a percentage of the rate base. RALPH NADER'S STUDY GROUP REPORT ON REGULATION AND COMPETITION, THE MONOPOLY MAKERS 5 (1973), cited in WEIDENBAUM 479.
  \item Simon 51-52.
  \item See Simon 49-50.
  \item Id. at 51.
  \item Simon 53.
\end{itemize}
$1 billion. Future costs would increase as the utilities took advantage of the program by increasing construction of power plants.

The Ford plan would provide "a cash contribution by the federal government for the construction of additional electric power plants" through the ITC and an "interest-free loan" through the normalized depreciation provisions. The plan ideally should reduce American dependence upon foreign oil by reducing our need for oil, increase the number of jobs in the construction industry, and provide for an assured source of electrical energy into the future. Because the plan will provide the utilities with additional investment capital, it should also reduce the pressure on the capital markets which the utilities would otherwise exert in search of additional investment funds.

Three specific problems with the Ford plan should be highlighted before turning to its conceptual weaknesses. First, the ITC may be excessive. The Tax Reduction Act of 1975 (TRA) has already increased the ITC for utilities from four percent to ten percent. Furthermore, the TRA altered the "percent-of-tax limitation" on the ITC with respect to public utility property. Prior to 1975, all businesses could take a full credit for qualified investment property up to $25,000 of their tax liability and then a 50 percent credit on their tax liability in excess of $25,000. The TRA provided that if 75 percent or more of a public utility's property is qualified

34. Wall Street J., June 16, 1975, at 4, col. 2.
35. Simon 53.
37. Simon 49.
38. FEA [Federal Energy Administration] has selectively advocated two . . . accounting practices designed to increase availability of internal capital. These practices are: a provision for allowance of funds used during construction (AFDC) and a provision for construction work in progress included in the rate base (CWIP). These devices are designed to increase internal cash flow and thereby reduce external capital needs. Letter from Donald B. Craven, Acting Assistant Administrator, Energy Resource Development, FEA to Brandon Becker, Sept. 3, 1975.
investment property, there would be no percent-of-tax limitation in 1975 or 1976. The 50 percent maximum would be phased back in by reducing the percentage by ten percent for each year beginning with 1977. Thus, the limit for 1977 is $25,000 tax liability plus 90 percent of the tax liability in excess of $25,000. In effect, the maximum of 50 percent will be reinstated by 1981. Therefore, when the Secretary of the Treasury noted that although the ITC would be increased "[n]o change of the percent-of-tax limitation is involved," it should be recognized that the utilities already have been given a tax incentive by last year’s Congress, both through an increase in the percent of investment qualified for the ITC and the percent-of-tax limitation. Thus, the effect of the TRA may be a sufficient incentive for the construction of additional power plants.

A second specific problem is exemplified by Secretary Simon’s statement:

[B]ecause of the limitation that the [ITC] may be used only to offset tax liability, the regulatory commissions will have to do their part by setting rates that are sufficient to create a reasonable profit and a tax liability against which the credit can be offset.

In other words, utility taxes may be so low that they cannot take advantage of the ITC. In fact, this may very well be the case for a significant number of utility companies:

[F]ederal tax payments by privately owned [power] companies have been declining steadily for the past decade or more, because of various tax benefits accorded utilities. [F]ederal income tax payments of the nation’s Class A and B privately owned utilities dropped in 1973 to a record average low of 2.6 percent of their operating revenues. Forty-nine of the nation’s investor owned companies paid no federal income tax at all.

This could lead to the Kafkaesque situation where a regulatory commission might be encouraged to set higher rates merely to take

42. Id. § 46(a) (6) (C).
43. Simon 51.
44. See text accompanying note 98 infra.
45. Simon 53.
46. EPP, supra note 13, at 391-92 (statement by Alex Radin, General Manager, American Pub. Power Assoc.).
advantage of the federal loan. The consumer would lose twice: He would pay more for electricity and he would pay indirectly for the tax incentive program, either through higher taxes, reduced social programs, or higher interest rates brought about by increased federal deficit spending.

The third specific objection is that elimination of the phase-in requirements for an ITC on progress payments is questionable. The Administration argues that these costs should be reflected as qualified investments for the determination of the ITC. Admittedly it takes a long time to construct a power plant; estimates range from four to seven years depending on the type of plant constructed. The TRA already has recognized this problem and provided the taxpayer with the option of taking an advanced ITC on the progress payments paid during the construction period before the property is placed in service. But the TRA provided for a five-year phase-in of the progress payments provision. The Administration would eliminate the phase-in requirement as to utility progress payments. Yet the Administration has not explained why the utilities should be exempt from the concern which Congress originally voiced in enacting the phase-in provision. The phase-in is designed
to minimize the possible doubling up effect of these [progress payment] provisions, where taxpayers would be taking [ITCs] for all property placed in service this year (even though progress payments had been made with respect to that property in prior years) as well as progress payments made in the year [in which the property is placed in service].

47. See Simon 53.
50. Id. § 46(d)(7).
To avoid doubling up of investment credits in 1975 (credits could be claimed on both property placed in service as well as progress payments), the progress payments rule is phased in over a five-year period at the rate of 20 percent a year.
Of the qualifying progress expenditures for 1975, 20 percent would qualify for advance credits. In 1976, 40 percent of qualifying progress expenditures, plus 20 percent of 1975 expenditures, would be available for advance credits. In 1977, 60 percent of qualifying progress expenditures in that year, plus 20 percent of both 1976 and 1975 expenditures, would be available. By 1979, the rule is scheduled to be completely phased in, with all progress expenditures qualifying for advance credits. CCH, TAX REDUCTION ACT OF 1975 ¶193 (Current Law Handybook ed. 1975).
There is no reason to believe that the “doubling up effect” originally feared by the House Ways and Means Committee would not occur with respect to the utilities under the Administration’s plan.

Aside from these specific criticisms of the Ford proposal, there are other reasons why the program should be questioned. First, there is a vertical equity problem. The ITC and depreciation provisions are linked to the amount of qualified investment property which each utility holds. The more dollars which an utility can invest, the more tax savings the company can generate for itself. Therefore, those utilities which are most in need will presumably acquire the least tax dollars because they will be limited in their ability to increase their investments. It might be argued that this is the proper result because the tax money should be spent only on those utilities which are competent enough to be profitable. Unfortunately, competency in this area may often be defined as the ability of management to obtain either favorable rate increases or reduced state and local taxes. Thus, because success in raising large amounts of investment funds would be rewarded with more tax dollars, the plan distributes the tax dollars neither on the basis of management skill nor on the basis of need for the funds. The painter has again used too broad a brush stroke.

Second, there is the decision whether society should further stimulate the growth of electric power through hidden subsidies. The Ford plan is designed to divert dollars to expand construction in the nonpetrol based utilities. But expanding firms can obtain a constant tax break through accelerated depreciation. Thus, tax incentives designed to meet a specific problem can become a long-term construction stimulus. Although it appears that societal dependence upon nonpetrol generated electricity will increase in the long term, the consumer will not pay the full production costs.

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52. Vertical equity is the assumption that in a progressive tax structure higher income brackets should pay more tax. Horizontal equity is the assumption that similarly situated taxpayers should pay an equal tax.

53. E.g., regulatory commission attitudes toward higher rate increases are now being factored into the determination of an utility’s bond rating. Weidenbaum 471.


of electricity so utilization decisions are divorced from production cost.

For example, assume that the Ford plan provided the utilities with $100 of investment funds through the ITC. Assume further that the revenue loss generated by the Ford plan is offset by a $100 increase in taxes. Given these assumptions and holding all else constant, at the end of the year, the consumer will have paid utility bills which are based on consumption minus $100 and have paid taxes which are based on income plus $100. While the consumer's bill is lower, higher federal taxes are rationalized as the "cost" of producing electricity. Attention is thus diverted from a viable policy alternative; electricity demand reduction.

Criticism of the Ford plan because it shifts the cost of producing electricity from the consumer to the taxpayer is ironic. The purpose of the Ford plan is to reduce dependency on foreign oil. The reason, however, why America originally became petroleum dependent was the beneficial tax incentives provided the oil industry. Although there is a certain symmetry in replacing one tax program with another, it is nevertheless anomalous to perpetuate reliance on tax policy rather than market forces of price, supply, and demand to allocate energy resources.

Not only do tax incentives misallocate resources, they also render decision-making in a democracy more difficult. The public is deprived of the ability to analyze effectively the program due to the obscurity of the tax law.

It may be that legislators and the beneficiaries of tax incentive programs . . . fear that once the public is fully aware of the amounts involved and can weigh expenditure costs against benefits received by the nation, the tax incentives will be found wanting in many respects. In this view, the deeper the incentive is buried in tax technicalities and tax terminology, the more it looks like any other technical tax provision, the more it partakes of the protective coloration of the tax law that can be obtained by such outward similarity to ordinary tax provisions, then the more desirable the tax in-

Swidler, The Role of Energy Conservation in a National Energy Policy, 2 ENVIRON. AFFAIRS 280, 281 (1972). The fact that electricity consumption may increase in an absolute sense is not inconsistent with a relative reduction in the rate of growth as discussed in the text accompanying notes 98-115 infra.

56. The figures will not necessarily be equal because there may be certain transfer costs associated with an attempt to provide the utilities with funds. In other words, it might require higher tax increases to provide the utilities with less money.

57. Comment, Taxation as a Tool of Natural Resource Management: Oil as a Case Study, 1 ECOLOGY L.Q. 749, 768, 770 n.105 (1971).
centive becomes. The public must dig hard and deep to find the subsidy and evaluate it.  

A less ideological, but equally important, argument is that a tax proposal is considered by the inappropriate congressional committee.

Tax legislation . . . goes to the House Ways and Means Committee and the Senate Finance Committee. These committees would normally not consider the substantive areas involved in tax incentive programs. Tax incentives suddenly charge them with acting on substantive matters outside their fields of responsibility simply because the program uses the tax system.

Finally, the question of who pays for the program arises. Increased taxes, reduced social spending, increased deficit spending, or some combination thereof will be necessary to pay for a $0.6 billion to $1 billion reduction of federal revenues. In fact, it has been suggested that such "tax incentives" should be viewed as "tax expenditures" to reinforce the idea that the government is spending money when it seeks to stimulate an economic sector through tax incentives. It does not appear unreasonable to ask who pays before the government spends.

Qualified Dividend Reinvestment Plan

The Ford plan would

59. Id. at 728–29.
60. See text accompanying notes 32–34 supra.
61. Surrey, supra note 58, at 715. Professor Surrey defines a tax expenditure as special exclusions or exemptions from income, deductions, credits against tax, deferrals of tax, or preferential tax rates. They serve ends, however, which are similar in nature to those served in the same or other areas by direct government expenditures in the form of grants, loans, interest subsidies, and federal insurance or guarantees of private loans. Surrey, Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance, 84 Harv. L. Rev. 352, 353–54 (1970).
See also S. Surrey, Pathways to Tax Reform: The Concept of Tax Expenditures (1973).
62. Simon 52. This is the only aspect of the Ford plan upon which the
This provision provides the utility companies with preferential access to the private money markets because utility stock will be more attractive to investors. The rationale for this provision is that since part of the utility financing problem is the utility's inability to attract external capital,\(^6\) the obvious solution is to allocate a greater portion of the funds available in the capital markets to the utility industry.\(^6\) In addition, this provision would assist the utilities in shifting away from their increasing reliance on debt capital and toward greater utilization of equity capital.\(^6\)

This program is inadvisable because it is a classic example of resource misallocation. The traditional rationale for reinvestment in equity has been its record of strong dividend payments and the assurance of future dividends. Normally, utilities can assure future dividends only if the state regulatory commissions assure the utilities of continued rate increases when justified by rising costs. The Ford plan shifts this cost to the intricacies of the Internal Revenue Code.

Furthermore, the funds provided by this provision would not go to those utilities most in need of additional funding. Whereas the ITC and accelerated depreciation provisions are allocated to any utility which can muster the necessary investment capital, stock purchases, presumably made by rational investors, will be allocated to the selected utilities which are presently financially secure and have obtained favorable rate increases from their state regulatory commissions.

Finally, effective tax planning may prevent these dividends from ever being taxed to anyone. The implicit purpose behind this provision is to induce taxpayers to invest their retirement savings in utility stock. The dividends would not be realized until the taxpayer was beyond his major income-producing years and therefore would be taxed at a lower rate. The tax planner would take this

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House Ways and Means Committee has acted. See note 6 supra. On the motion of Representative Waggonner (D. La.), the Committee rejected, 14 to 11, the Ford proposal, criticizing it as "a narrow, special-interest provision that would have set a bad precedent." Wall Street J., Oct. 29, 1975, at 4, col. 2, (pac. ed.) (The Wall Street Journal is bound in the eastern edition).

63. "The possible sources of internal financing . . . consist of depreciation and retained earnings. . . ." W. BRANSON, MACROECONOMIC THEORY AND POLICY 204 (1972). The basic idea is that internally generated funds are obtained through sales to customers and externally generated funds are obtained from investors, either creditors or stockholders.

64. See Department of the Treasury, Technical Explanation of the Electric Power Facility Construction Incentive Act of 1975 at 15-16.

65. Id.
proposal one step further. If the taxpayer could retain the stock until his death, then the decedent's legatees would acquire the property with a basis equal to the fair market value of the stock at the date of the decedent's death\textsuperscript{66} (or the optional valuation date).\textsuperscript{67} Since the legatee's basis would incorporate the qualified dividends previously paid to the decedent, immediate sale of the stock by the legatee would produce no income to be taxed. The possibility of the taxpayer passing the utility stock to his legatees is limited. The average utility stock is only held for six years from the date of purchase\textsuperscript{68} and if the taxpayer sold any of the utility's stock \textit{inter vivos}, the first stock disposed of by the taxpayer would be deemed qualified dividend stock. In effect, once the taxpayer obtained qualified dividend stock, the taxpayer would have to hold all of that utility's stock which he owned until his death to pass the tax exemption onto his legatees. Nevertheless, the need to provide additional funds to the utility industry does not justify allowing the taxpayer to pass on the tax advantage to his legatees without incurring any taxation of income.

"Lockheed"-Type Loan Guarantees

Although not a portion of the original utility financing scheme of the Administration, a provision to provide federal credit assistance to the utility industry may be included in the Ford program.\textsuperscript{69} Credit assistance would consist of either guaranteeing utility debt or the

\begin{itemize}
\item \textsuperscript{66} INT. REV. CODE OF 1954, § 1014.
\item \textsuperscript{67} Id. § 2032.
\item \textsuperscript{68} The Office of Economic Impact of the Office of Analysis of the Federal Energy Administration, supra note 32, at 9.
\item \textsuperscript{69} The President's position is in a state of flux. His most recent major policy statement is a call for the creation of an Energy Independence Agency (EIA) "to channel $100 billion into energy projects over the next decade." Wall Street J., Sept. 23, 1975, at 3, col. 1 (pac. ed.) (The Wall Street Journal is bound in the eastern edition).
\item [The EIA] would guarantee private loans to industry in some cases and would raise its own loan capital by selling its government-backed bonds in others. In some cases, the authority might build nuclear power plants and other major installations itself, then lease or sell them back to private industry.
\item Besides its financial aid, the [EIA] would try to expedite regulatory decisions. It wouldn't have the power to override those decisions, however. Id.
\end{itemize}

See also note 6 supra.
outright purchase of a nuclear\textsuperscript{70} power plant which would then be leased to the utility company.\textsuperscript{71} The obvious advantage of this type of provision is that it provides the necessary financing for utility expansion.

The problems with this type of plan are more financial than legal. In effect, this provision would only shift the utility capital requirements onto some other sector of the economy which does not have the benefit of government guarantees. The Securities Industry Association explains the rationale which is supported by the available econometric literature:\textsuperscript{72}

Federal credit programs are preemptive in their demand for credit and generate heightened competition for funds and higher interest rates. In effect, federal agency lending operations take would-be debtors that have been price-rationed out of the capital markets and reinject them as an agency borrowing with federal government backing. Since these programs do not increase the total supply of savings in the economy, their operation merely pushes the pressures along. Market rates of interest go up to create a new margin of hardship cases in some area that is not insulated.

Federal credit programs can be perverse in their impact on monetary and fiscal policy. Under [the present] conditions of restrictive credit, when monetary policy is forced to work overtime to curb demands by squeezing out would-be borrowers, the injection of new, strongly-positioned demands by federal agencies intensifies the restraint.\textsuperscript{73}

Those sectors of the economy which would be forced out\textsuperscript{74} of the

\textsuperscript{70} The nuclear energy debate is beyond the scope of this Comment. Compare Green, Nuclear Power, Risk, Liability and Indemnity, 71 Mich. L. Rev. 479 (1973) with Palfrey, Energy and the Environment: The Special Case of Nuclear Power, 74 Colum. L. Rev. 1375 (1974). Professor Green, anti-nuclear, and Professor Palfrey, pro-nuclear, are both former Commissioners of the late Atomic Energy Commission.


\textsuperscript{72} Weidenbaum, Dangers in U.S. Aid for Utilities, Wall Street J., Jan. 23, 1975, at 14, col. 3.

\textsuperscript{73} Federal Financing Authority: Hearings on S. 1015, S. 1699, S. 3001, & S. 3215 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 92d Cong., 2d Sess., at 105 (1975).

\textsuperscript{74} See EPP 383 (statement by Michael McCloskey, Executive Director, Sierra Club); WEIDENBAUM 501-505; Kaufman, Federal Debt Management: An Economist's View from the Marketplace, in Issues in Federal Debt Management 155, 173 (conference series no. 10, Federal Reserve Bank of Boston, 1973) (view of partner & economist of Salomon Brothers investment firm); Maclaury, Federal Credit Programs—The Issues They Raise, in id. 205, 217 (President, Federal Reserve Bank of Minneapolis); Weidenbaum, Dangers in U.S. Aid for Utilities, Wall Street J., Jan. 23, 1975, at 14, col. 3.

An Administration response to this criticism might be twofold. First, the small borrower will not be forced out of the capital markets in an absolute sense, the borrower will just have to pay higher interest rates.

Any increase in the demand for a limited commodity such as capi-
capital markets include state and local bonding,\textsuperscript{75} housing\textsuperscript{76} and agriculture.\textsuperscript{77}

Lastly, if the Federal Reserve Board pursued an expansionary monetary policy to meet the additional capital demands generated

tal has the effect of restricting the availability and increasing the cost. The direct effect of Federal deficits and energy financing is therefore, more a question of what it will cost, relative to the small borrower's ability to pay, than its general availability. Letter from Donald P. Craven, Acting Assistant Administrator, Energy Resource Development, FEA to Brandon Becker, Sept. 3, 1975.

Second, capital markets will expand to absorb future capital demands. It is generally acknowledged that increased demand for funds in the capital markets on the part of government and other high-rated borrowers can, in times of tight money, restrict credit availability to lower rated corporate borrowers and the housing sector. There are those who believe that "crowding out" is and will become a significant factor in the credit markets in the years ahead. There are also those who believe that a growing economy over the next decade, with appropriately steady fiscal and monetary policies, will manage to generate sufficient capital for all those credit-worthy borrowers that come to market. Letter from Henry H. Perritt, Jr., Deputy Under Secretary for Economic Policy Review of the Department of Labor, to Brandon Becker, Oct. 6, 1975.

The second line of analysis begs the question with the term "credit-worthy borrowers."


76. "An increase of one percentage point in the interest rate lowers housing expenditure by $2 billion within nine months and by $3 billion after a year." L. Ritter & W. Silber, Money 60 (1970). An increase in the demands for capital within the money markets will force out the housing sector or increase interest rates. See note 74 supra. See generally Housing and Monetary Policy (conference series no. 4, Federal Reserve Bank of Boston ed. 1970).

by federal credit assistance, greater long-run inflation would result.\textsuperscript{78}

**AN ALTERNATIVE APPROACH: THE REDUCTION OF CAPITAL REQUIREMENTS**

The previous section assumed that projected capital requirements for the electric utility industry were equivalent to necessary capital expenditures. In contrast, this section will assume that the projected shortfall of capital availability within the electric utility industry indicates that the necessary capital expenditures must be reduced so that capital needs are equivalent to capital availability. The Acting Assistant Administrator for Energy Resource Development of the Federal Energy Administration (FEA) explains:

> A direct relationship exists between the capital requirements of the electric utility industry and the projected demand. The capital requirements of the industry are determined by projecting future electricity demand and calculating the degree of physical expansion which will be necessary to meet the future demand. Historical growth patterns in themselves represent only a specific level of expansion and therefore are only useful as possible indicators of future demand patterns. As the level of electricity growth expands and contracts, so also do the industry's capital requirements.\textsuperscript{79}

Since the projections for the electric utilities' future capital requirements have been primarily determined by an extrapolation of past trends,\textsuperscript{80} alterations in the present pattern of electricity production and consumption could significantly reduce future requirements for utility capital.

There are two ways to reduce the future capital requirements of the industry—minimize the cost of producing electricity or re-

\textsuperscript{U.S. Policy and World Food Need, supra at 12, 14 (statement by Lester Brown and Erik Eckholm, Senior Fellows with the Overseas Development Council), at 74-75 (statement by Raymond Ewell, Prof. of Chemical Eng'g, S.U.N.Y. at Buffalo). Farming will increasingly rely upon external financing from the available capital markets. ORGANIZATION FOR ECONOMIC Coor-ERATION AND DELOPMENT, 2 CAPITAL AND FINANCE IN AGRICULTURE 7, 53 (1970). See Note, World Hunger and International Trade: An Analysis and a Proposal for Action, 84 YALE L.J. 1046, 1076-77 (1975) advocating $5.5 to $7 billion annual investment in developing market countries to increase food production and stabilize population growth. It is likely that agriculture could be one of the small borrowers forced out of the capital markets by the preemption of capital which would result from federal support for energy financing. See generally note 74 supra.

\textsuperscript{78. See Bechter, Money and Inflation, FEDERAL RESERVE BANK OF K.C. MONTHLY REV. 3, 6 (July-Aug. 1973) (results the same under a structural and monetarist model).


\textsuperscript{80. A. Hammond, W. Metz, & T. Maugh, Energy and the Future 139, 142 (1973).}
duce the demand for electricity. The Ford plan does not address either alternative. Rather the Ford plan apparently assumes that the only alternative to the capital shortage within the utility industry is to provide the utilities with more money.

Interconnection

Production costs for electric utilities will not require less capital investment in the foreseeable future. Even so, gross investment could be reduced by a system of interconnection. Interconnection is the process by which one power company provides another power company with additional electricity and is designed to take advantage of the demand diversity which exists between individual power companies. For example, if one power company experiences its greatest demand for electricity during four to six in the evening, eastern standard time, and another company has its peak demand period during four to six, central standard time, it may be possible for the central company to transfer power to the eastern company when the central company plants are not operating at full capacity. This transfer of power would reduce the need for both companies to build additional plants to meet their individual peak demand requirements.

Time zone diversity is only one example of how interconnection can reduce costs. The capital expenditure savings generated by interconnection result from the fact that the industry as a whole does not have to build additional plants to meet the demand require-

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81. See, e.g., Financial Requirements of the Nation's Energy Industries: Hearings on S. Res. 45 Before the Senate Comm. on Interior and Insular Affairs, 93d Cong., 1st Sess., ser. 93-5 (92-40), at 13 (statement of William Pelly, Vice-President, Petroleum Dept, First Nat'l City Bank) (15 year lag until technological changes have capital impacts); Plumlee, supra note 48, at 23 (solar capital costs will exceed present capital costs for present plants); INTERTECHNOLOGY CORP., 1 THE U.S. ENERGY PROBLEM SUMMARY 60 (1971) (capital costs for an ocean thermal gradient system would exceed world monetary resources).


83. S. BREYER, supra note 82, at 92-93.
ments of individual companies. In other words, a national power grid is established to take advantage of what would otherwise be excessive duplication within the entire system.\textsuperscript{84} The debate within the utility industry has focused on the dollar amount which can be saved through greater interconnection at this time. The industry has argued that they have already achieved the fullest degree of interconnection possible at this time.\textsuperscript{85} Industry critics, however, contend that intra-industry rivalry has frustrated attempts to achieve full interconnection.\textsuperscript{86} The dollar estimates have varied from an industry suggestion that greater interconnection would be more expensive\textsuperscript{87} to a critical view which suggests savings as high as $10 billion.\textsuperscript{88} The “reasonable and conservative” estimate of “total annual savings of $2 billion” by a recent Brookings publication appears to strike a happy medium.\textsuperscript{89}

The Ford plan is designed to provide the utilities with 3.7 billion dollars. Thus, effective interconnection might save the consumer 54 percent of the funds which the Ford program is designed to provide through tax incentives and higher prices.

**Demand Reduction**

If the demand for electricity is reduced, capital expenditures will also be reduced because if less electricity is consumed fewer plants have to be built.\textsuperscript{90} There are basically two ways to reduce demand for additional electricity; government regulation and higher prices. Although the vagaries of governmental intervention in the marketplace are dependent upon future elections, electricity prices will surely rise.\textsuperscript{91} The question is whether the price increases which the utilities have obtained\textsuperscript{92} and will obtain in the future, will

\textsuperscript{84.} EPP 261-62.  
\textsuperscript{85.} WEIDENBAUM 524.  
\textsuperscript{87.} WEIDENBAUM 524.  
\textsuperscript{88.} EPP 262.  
\textsuperscript{89.} S. BREVER & P. MACAVOY, supra note 82, at 107.  
\textsuperscript{90.} Although this is true in the aggregate, specific cases may differ. For example, demand might decrease with respect to a particular utility company’s total production, but the demand might increase during a specific time period which required the construction of additional power plants to meet that demand period.  
\textsuperscript{92.} Since 1970, however, electric rates have gone up faster than the overall cost of living—three to four times faster in 1974... Last year [regulatory] commissions approved a total of $2.2 billion in
reduce the future demand for electricity such that the projected capital needs of the utilities will not develop in the future.

The consensus of economists is that in the long run, higher prices for electricity will reduce demand. The economists cannot say with certainty or authority how much demand will be reduced or when it will be reduced. Even so, the most recent demand studies indicate a sharp drop in consumption levels. The pre-1974 studies, were based on the continuation of an historical growth rate of seven percent. The post-1974 studies, which are only now beginning to appear, indicate that the future growth of electricity consumption will be approximately five and one-half percent annually, a figure one and one-half percent lower than pre-1974 predictions.

Since virtually all of the projected capital investment of the electric utilities will be devoted to the expansion of capacity, demand reduction should have a substantial impact upon future capital requirements. It is estimated that demand reduction will lower utility capital requirements by as much as 33 percent.

The implications of reduced capital requirements are presently filtering through the utility industry.

Already there is some evidence that the slower growth in electricity sales and the resulting construction budget cutbacks in 1974 have
resulted in an improved financial condition for the industry. Better financing terms and the increased investment tax credit have reportedly been responsible for electric utilities again moving ahead with their construction plans. In a recent study completed by the Edison Electric Institute on economic growth, pricing and energy use, a major policy conclusion was reached that investor-owned utilities would opt for a moderate growth rate in electricity sales of from 5.3 percent to 5.8 percent for the remaining quarter of the century.

The policy implications of these figures are twofold. First, the predictions of a capital shortfall in the utility industry usually assumed historical growth trends and in any case did not incorporate the impact of higher prices. Thus, the capital needs of the utility industry will not be as great as originally forecast. And the justification for a massive program of federal intervention within the marketplace is reduced. Second, demand reduction should accomplish the goals of the Ford plan. Demand reduction reduces environmental degradation, lengthens domestic energy supplies, and reduces American dependence on imported oil.

The primary disadvantage of demand reduction is its alleged effect on gross national production. Specifically, the Ford Administration has argued that an incidental advantage of its program would be increased employment within the construction industry. This argument is flawed for several reasons. First, the position is internally inconsistent. One of the justifications for the Ford program is that the utility industry is uniquely capital-intensive, as opposed to using a significant amount of labor. Thus, if jobs are the policy goal, the funds could be spent more advantageously by directing them to a labor-intensive industry.

Second, the reduction in economic production argument is primarily applicable to government-enforced demand reduction through regulations or legislative fiat. In the present case, the demand reduction will result from the price increases which the utility industry has sought from the state regulatory commissions. It would be logically inconsistent for the utilities to justify higher prices at the state regulatory commissions due to their need to at-

99. See text accompanying note 44 supra.
100. Professor Weidenbaum worked under the auspices of the Edison Electric Institute, a major utility trade association. See note 2 supra.
101. Lancaster, supra note 95, at 10-11 (emphasis & footnotes added).
102. WEIDENBAUM 472.
103. HAMMOND, supra note 80, at 131.
104. Simon, supra note 5, at 49.
105. See id. at 49, 53.
106. See, e.g., EPP 367-68 (statement by Donald C. Burnham, Chairperson, Westinghouse Electric Corp.).
tract additional capital and then to argue for tax subsidies from the federal government so that the higher prices granted at the state level will not reduce growth.107

CONCLUSION

Utilities can maintain a sound financial position with moderate rate increases from state regulatory commissions.108 Federal financial intervention through tax incentives is only appropriate to rectify market dislocations109 created by a shift of national priorities, specifically in the areas of pollution control and conversion of petroleum plants to a nonpetroleum fuel base. If tax incentives are granted, they should be of a short duration to assure congressional reexamination of the expenditure decisions.110

The Ford plan should not be adopted. The Tax Reduction Act of 1975 has ameliorated many problems of capital formation within the utility industry. Moreover, capital needs should decrease as a consequence of demand reduction. Lastly, the utility industry itself could increase its capital significantly through fuller intra-industry cooperative techniques such as interconnection.

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107. On the other hand, it could be argued that the tax subsidy is necessary as a stimulant to future growth, irrespective of the marketplace distortion such a subsidy would provide for electricity consumption. An analysis of this position is beyond the scope of this Comment, although several observations are appropriate. The economic stimulus argument would have to entail a consideration of several factors: the environmental impact stimulants to future energy consumption would generate, a comparison of the alternative methods to stimulate future economic growth, and most importantly, since most neglected, an analysis of the trade-off which would occur by stimulating electricity growth rather than demand reduction (i.e., will more nuclear power plants be built to provide more energy and fewer homes insulated to use less energy?).


109. Id. at 109. Accord, WEIDENBAUM 434.

110. Surrey, supra note 58, at 738.